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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 7/27/84 Number: 169039CA Due By: _____Subject: Cabinet Council on Economic Affairs Planning Meeting - July 30, 1984
Saving: The U.S. Experience
10:00 a.m. - Roosevelt Room TOPICS: Economic Impact of Demographic Shift

	Action	FYI		Action	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input checked="" type="checkbox"/>			
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Baker	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Darman (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	McFarlane	<input type="checkbox"/>	<input checked="" type="checkbox"/>
HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Svahn	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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Education	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Counsellor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>			
UN	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Executive Secretary for:		
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CCCT	<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	CCEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
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NASA	<input type="checkbox"/>	<input type="checkbox"/>	CCHR	<input type="checkbox"/>	<input type="checkbox"/>
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VA	<input type="checkbox"/>	<input type="checkbox"/>	CCMA	<input type="checkbox"/>	<input type="checkbox"/>
SBA	<input type="checkbox"/>	<input type="checkbox"/>	CCNRE	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

There will be a Cabinet Council on Economic Affairs Planning Meeting on Monday, July 30, 1984, at 10:00 a.m. in the Roosevelt Room.

The agenda and background papers are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823 (White House)

☐ Don Clarey ☒ Tom Gibson ☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs
456-2800 (Room 129, OFOR)



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THE WHITE HOUSE

WASHINGTON

July 26, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *RBP*
SUBJECT: Agenda and Papers for the July 30 Meeting

The agenda and papers for the July 30 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 10:00 a.m. in the Roosevelt Room.

The first agenda item concerns trends in saving and investment in the United States. Several weeks ago, the Council requested a study on the U.S. experience with respect to saving and for an explanation of alternative measures of saving.

The Department of Commerce was requested to undertake the study. The paper has benefitted from comments and suggestions made by the Department of the Treasury, the Office of Management and Budget, and the Council of Economic Advisers.

The second agenda item is part of the study of the economic effects of demographic shifts. Immigration and its impact on the economic is one of the subjects the Working Group was asked to address. A paper from Sidney L. Jones, the chairman of the Working Group, on this subject is also attached.

Attachments

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

July 30, 1984

10:00 a.m.

Roosevelt Room

AGENDA

1. Saving: The U.S. Experience (CM # 487)
2. Report from the Working Group on the Economic Impact of Demographic Shifts (CM # 403)



UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for Economic Affairs
 Washington, D.C. 20230

July 17, 1984

MEMORANDUM FOR Cabinet Council for Economic Affairs

FROM:

Sidney L. Jones
 Sidney L. Jones

Under Secretary for Economic Affairs

SUBJECT: "Saving -- United States Experience"*

This paper responds to CCEA's request for information on trends in United States saving and investment relative to GNP and for an explanation of alternative measures of saving.

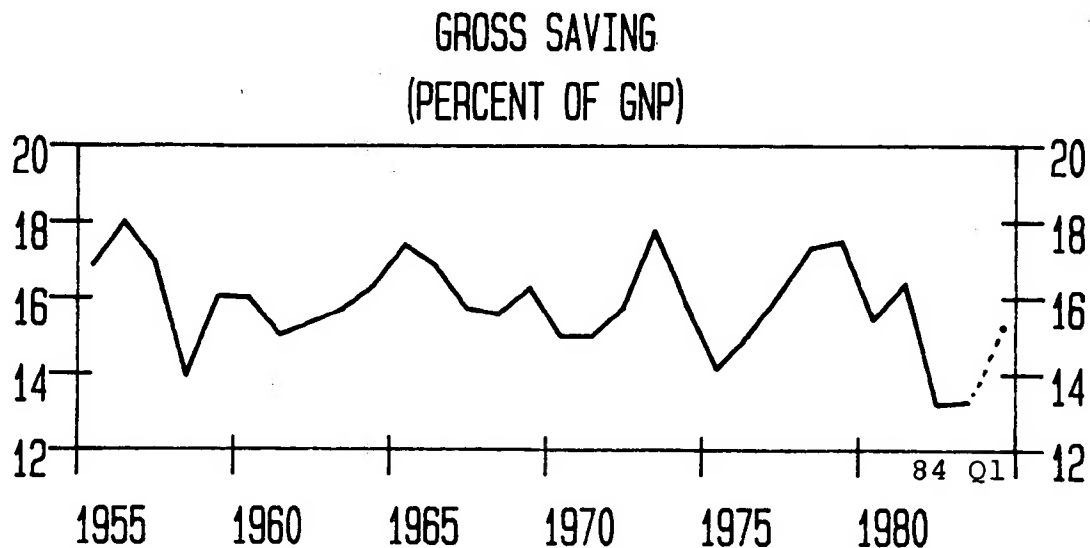
There are seven sections: (1) a definition of gross saving and gross investment and a description of their trends since 1955; (2) an explanation of differences between the National Income and Product Accounts (NIPA) and Flow of Funds (FOF) measures of saving; (3) an analysis of the personal saving component of gross saving; (4) an explanation of the difference between gross and net saving (i.e., economic depreciation); (5) a discussion of the relationship between saving and net worth; (6) a brief comparison of United States and selected foreign saving rates; and (7) an overview of broad policy approaches for increasing United States saving rates.

I. Gross Saving and Investment: Definitions and Trends

Gross saving (\$405.8 billion in 1982 and \$439.6 billion in 1983) equals total income (GNP or the sum of incomes -- wages and salaries, profits, proprietor and rental income, interest, depreciation, etc.) less private and government consumption. Since GNP less private and government consumption is also defined as investment, gross saving is equal to gross investment. They differ empirically by a small amount because of errors in measurement, or statistical discrepancy. During the period 1955 to 1983, gross saving averaged 15.9 percent of GNP, expressed in nominal dollars. Aside from economic downturns, when gross saving declines relative to GNP, the ratio has been remarkably stable.

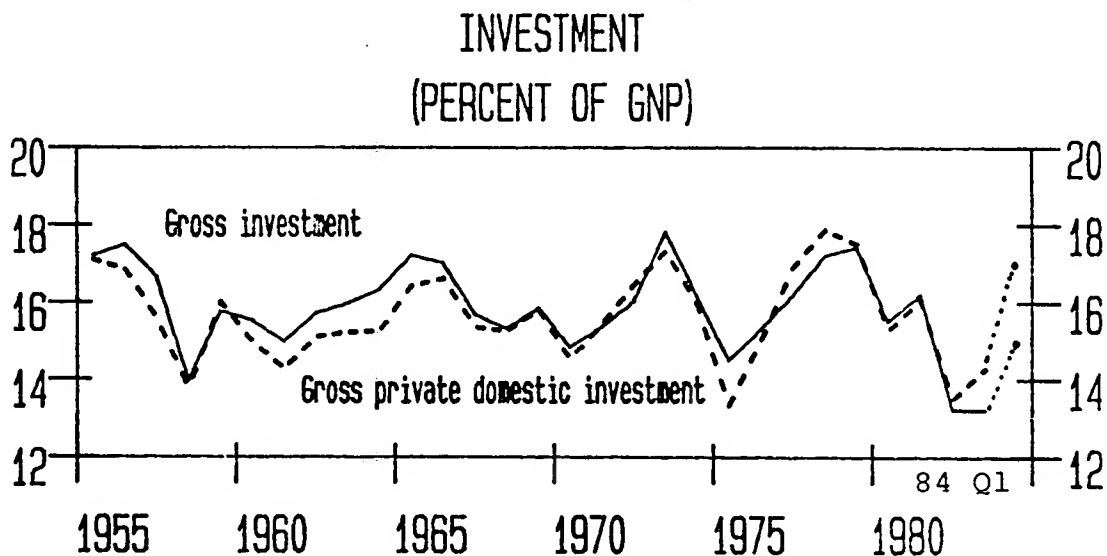
During 1982 and 1983, however, gross saving fell to 13.2 percent of GNP, a low annual average by post WWII standards. By the fourth quarter of last year the ratio had recovered to 14.1 percent, still below every annual average since 1955 except for 1958; and by the first quarter of 1984 the ratio reached 15.1 percent.

*Prepared by H. Kemble Stokes, Economist
 Office of the Chief Economist
 Department of Commerce



Gross investment may be viewed as two parts, gross private domestic investment and net foreign investment. Net foreign investment can be positive or negative depending upon whether people in the United States are investing more abroad than foreigners are investing here. It approximates the current account balance in international transactions (with the opposite sign for the capital flow figure).

Gross private domestic investment has averaged 15.6 percent of GNP during the period since 1955, slightly less than gross saving. The difference reflects the fact that, on balance, the United States was investing a portion of its gross saving abroad. During 1982 and 1983, however, the historical pattern has been reversed. Net foreign investment has been negative, that is the United States has become a capital importer, and the current account balance has been in deficit. In fact, in 1983, gross investment and saving were below gross private domestic investment by \$35 billion, or 1 percent of GNP. By the first quarter of this year this difference was \$79 billion or 2 percent of GNP.



Gross private domestic investment rose from 13.5 percent of GNP in 1982 to 14.3 percent of GNP in 1983. By the end of 1983, the ratio (at 15.5 percent) had almost regained its 1955-83 average; by the first quarter of 1984 it had reached 17.0 percent.

Ratios of private domestic investment to GNP may be expressed either in nominal or real terms (1972 dollars). Any differences in real vs. nominal ratios which develop over time reflect changes in prices of investment goods relative to all goods and services produced. Gross private domestic investment, in real terms, was 14.3 percent of GNP in 1983. It rose to 17.2 percent in the first quarter of 1984, well above its long-term average of 15 percent. The investment/GNP ratio has improved less in current dollar terms than in real terms because prices of investment goods declined relative to the GNP deflator in each of the last two years.

II. NIPA vs. FOF Measures of Saving

Gross saving can be calculated either as the difference between total income and current outlays (NIPA) or as the increase in assets less the increase in liabilities (FOF). Income not used for current consumption may be used to increase asset holdings or to reduce liabilities or both. If there were no conceptual differences or errors of measurement the two approaches to estimate gross saving would give identical results.

The Bureau of Economic Analysis (BEA) uses the income less outlays approach to estimate saving in the NIPA. The Federal Reserve uses both approaches in developing the FOF accounts, and shows any differences between the NIPA and FOF measures as statistical discrepancies.

Conceptual and Empirical Differences. There are important conceptual differences between the NIPA and the FOF. The major difference deals with the treatment of consumer durables. In the NIPA, all consumer spending is treated as current consumption, even though purchases of consumer durables (cars, furniture, boats, etc.) could be considered to have an investment component as well. The FOF classifies purchases of consumer durables as investment, or saving, and the depreciation on the stock of consumer durables as current consumption. (While a similar distinction could be drawn with respect to government purchases of durable goods or structures and machinery and equipment, both the NIPA and the FOF treat these as current outlays.)

A second difference affects the distribution of saving between the public and private sector. In NIPA, government life insurance and retirement funds are treated as social insurance contributions and transfer payments. Changes in these variables are reflected in personal income. In the FOF, however, life insurance and pension claims are treated as personal assets with the liabilities in the

Federal government sector and in state and local retirement funds, a separate financial sector. Relative to the NIPA, this shifts saving from the Federal government and state and local retirement funds to households.

A third difference is the treatment of special drawing rights (SDR's) when created and distributed by the International Monetary Fund. NIPA treats these as capital transfers from abroad, a component of saving that offsets the rise in SDR holdings included in net foreign investment. The FOF does not count them as saving on the grounds that they are not actual transactions.

These conceptual differences make direct comparisons of NIPA and FOF saving measures impossible. In this section, FOF and NIPA estimates have been made comparable by the following adjustments:

- o Gross Personal Saving. This sector includes households, farms, and nonfarm noncorporate business. The NIPA estimate is made by subtracting current outlays from disposable income and adding the noncorporate capital consumption allowance. The FOF estimate is made comparable to the NIPA definition by adjusting the net accumulation of real and financial assets for government insurance and pension reserves, consumer durables purchases and depreciation, capital gains distribution from mutual funds, and net saving by farm corporations.
- o Financial Saving. NIPA saving is the current surplus of banks, nonbank financial institutions, sponsored agencies, and Federal Reserve Banks, plus capital gains distribution of mutual funds. The comparable FOF estimate is the current surplus of the monetary authority, plus capital gains distribution of mutual funds, plus the net financial and physical investment of banks, nonbank financial institutions, and sponsored agencies.
- o Nonfinancial Corporate Saving. NIPA saving reflects undistributed corporate profits, capital consumption allowances and adjustment. The comparable FOF estimate is net financial investment plus capital expenditures for nonfinancial corporations plus saving by corporate farms.
- o Government Saving. The NIPA measure is the difference between receipts and expenditures. The FOF estimate for the Federal sector is net financial investment plus insurance credits to households less mineral rights sales. For the state and local sector the FOF estimate is net financial investment plus retirement credits to households.

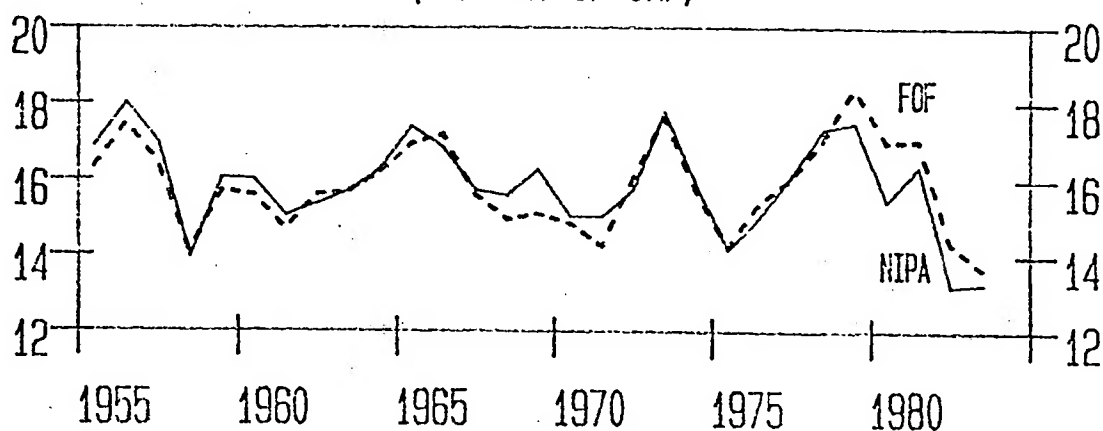
The NIPA estimate of gross saving in 1983 was \$439.6 billion, compared with an adjusted FOF estimate of \$451.7 billion. In earlier years the difference in domestic saving was larger and was approximately the mirror image of the difference in foreign sector saving. The following table provides details by major sector.

Summary Comparison of NIPA and FOF Measures of Saving in 1983
(\$ billion)

	<u>NIPA</u>	<u>FOF</u>	<u>NIPA-FOF</u>
Personal (gross)	259.3	316.5	-57.2
Non-Corporate Cap.			
Con. Allow.	145.7	145.7	
Net Saving	113.6	170.8	
Financial Bus.	25.4	36.4	-11.0
Banking	12.0	22.3	
Non Bank	7.7	9.2	
Mutual Funds	3.4	3.4	
(cap. gains dist.)			
Sponsored			
Agencies	1.7	0.9	
Monetary			
Authority	0.6	0.6	
Nonfinancial Corp.	285.3	242.0	43.3
Non Farm	282.4	239.1	
Farm	2.9	2.9	
Undist. Prof.	-0.1	-0.1	
Cap. Con. Allow.	2.8	2.8	
Cap. Con. Adj.	0.2	0.2	
Federal Gov.	-181.6	-187.8	6.2
State & Local Gov.	51.4	44.6	6.8
 TOTAL DOMESTIC SAVING	 439.6	 451.7	 -12.1
 <u>Addendum</u>			
Foreign Saving	34.6	34.4	0.2

Historical Perspective. During the period 1955 to 1983 the NIPA measure of gross saving averaged 15.9 percent of GNP, while the adjusted FOF measure averaged 15.8 percent. However, between 1979 and 1982 the difference averaged slightly over 1 percent of GNP or \$29 billion. In 1983 the difference was \$12 billion or 0.4 percent of GNP.

GROSS SAVING : NIPA vs. FOF (PERCENT OF GNP)



These aggregate data can be broken down by sector, as was done for 1983 in the table on page 5. Both the NIPA and FOF estimates require estimates of flows of production and incomes and of financial assets and liabilities among sectors, which are likely to be less reliable than the total.

Personal Saving. In 1983, net saving, according to FOF definitions, was \$279.8 billion, or 12.0 percent of disposable income. By contrast, personal saving (NIPA) was only \$113.6 billion, or 4.9 percent of disposable income. While part of the divergence reflects definitional differences, part reflects a relatively large statistical discrepancy.

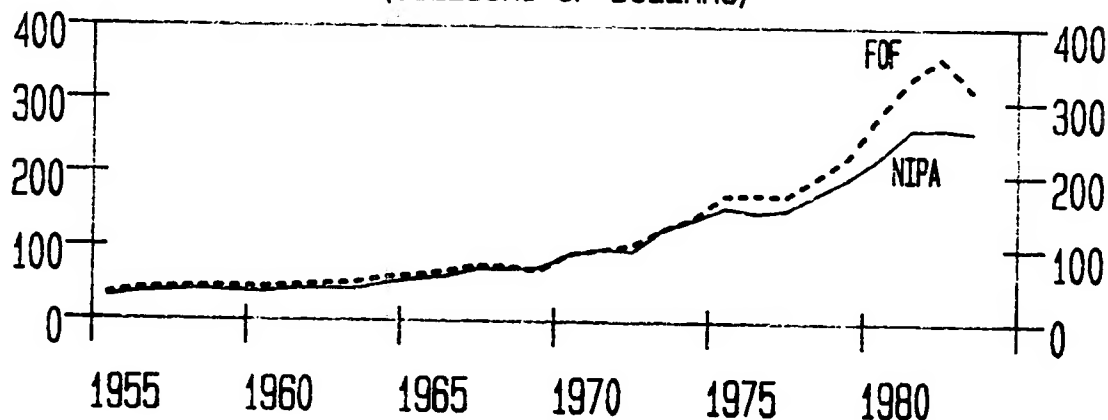
Two Definitions of Personal Saving: 1983

	(\$ billions)	% of <u>Disposable Income</u>
FOF	279.8	12.0
-Gov. Insurance & Pensions	56.3	2.4
-Consumer Durables	49.3	2.1
-Capital Gain Distribution from Mutual Funds	3.4	0.1
-Net Saving by Farm Corp.	0.1	-
-Discrepancy	57.1	2.4
=NIPA	113.6	4.9

Some observers contend that the FOF measure of personal saving is preferable to the NIPA measure because the former is a direct measure of changes in personal assets and liabilities. The NIPA obtains personal saving residually. Thus, any error in either the income or outlay series will affect the NIPA estimate. The FOF estimate, however, is also a residual. Personal sector saving is estimated by subtracting changes in assets and liabilities of each of the other sectors from the total. The same criticisms which apply to the NIPA, therefore, apply also to the FOF, and neither approach is inherently superior.

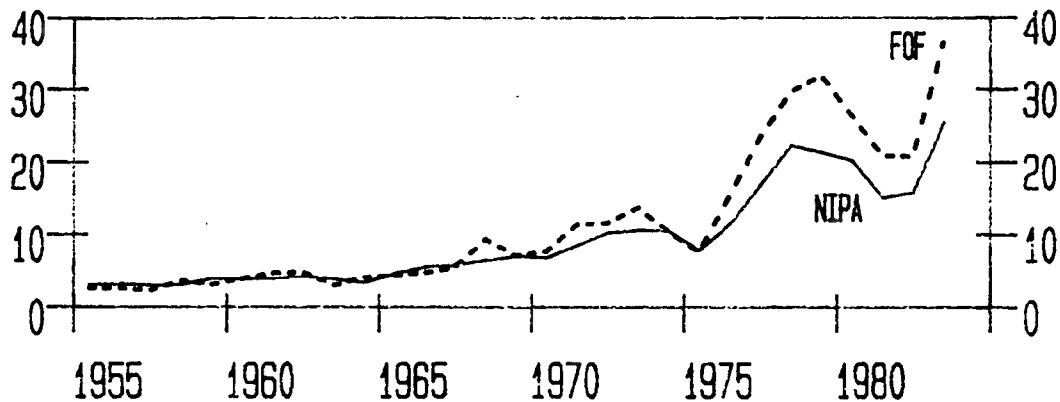
NIPA gross personal saving has been below FOF estimates, adjusted for definitional differences, in nearly every year since 1955. In recent years, the discrepancy has been quite large, reaching a peak of \$97 billion in 1982. In 1983, the difference was \$57 billion, though it declined during the year and virtually disappeared by the first quarter of 1984.

GROSS PERSONAL SAVING (BILLIONS OF DOLLARS)



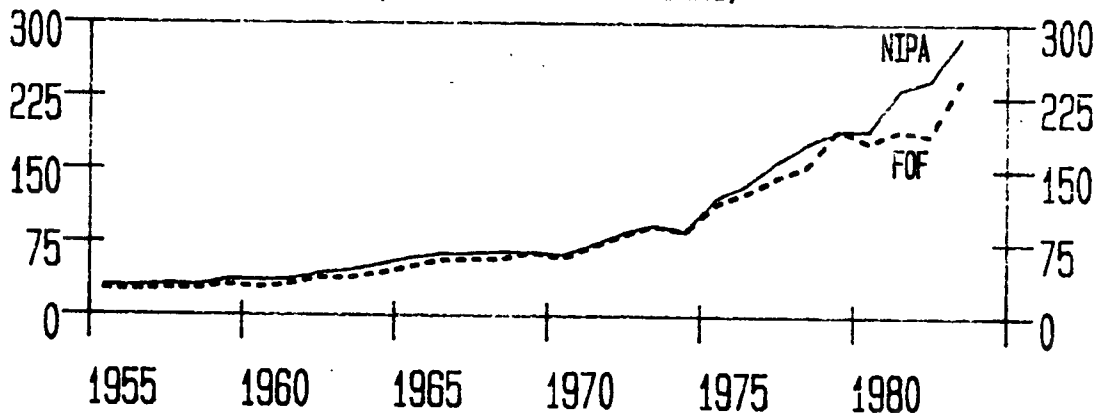
Financial Sector. Differences in the measures of saving for the financial sector were negligible until the mid-1970's. Since then, however, the difference has averaged about \$6 billion-\$7 billion, or 34 percent of the NIPA estimate.

GROSS SAVING : FINANCIAL SECTOR (BILLIONS OF DOLLARS)

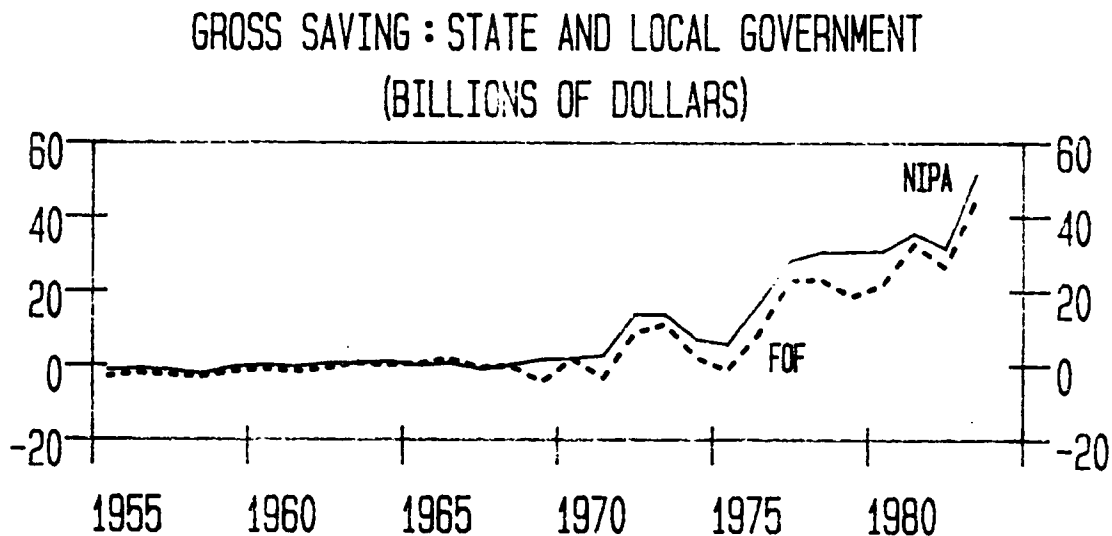
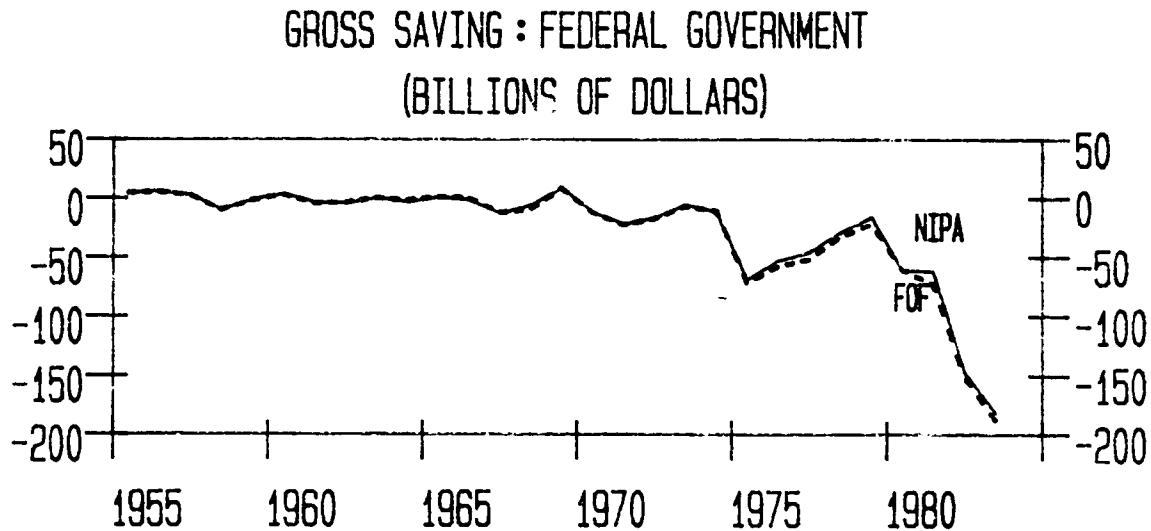


Nonfinancial Corporate Sector. The NIPA measure of gross saving has been consistently larger than the FOF measure. During the second half of the 1950's and 1960's, the difference averaged about \$6 billion (12 percent). In the last three years, the NIPA measure exceeded the FOF measure by nearly \$50 billion (20 percent).

GROSS SAVING : NONFINANCIAL SECTOR (BILLIONS OF DOLLARS)



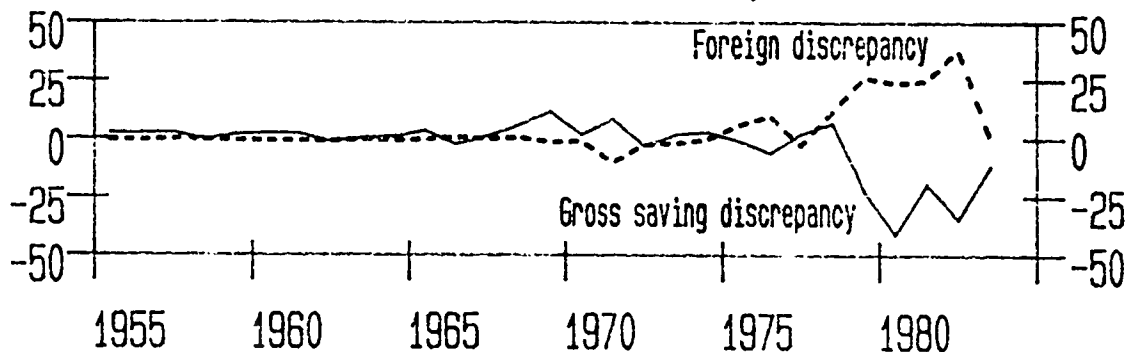
Government. Discrepancies between the two measures of saving for the Federal government sector are small; for state and local governments the discrepancies were historically small until the late 1970's and early 1980's.



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A large part of the difference in the two measures of gross saving appears to be reflected in the statistical discrepancy in the international balance of payments. By definition, once the conceptual differences have been resolved, the difference between the two measures of saving is composed of the FOF discrepancy between assets and liabilities, the NIPA discrepancy between income and expenditures, and the statistical discrepancy in the international balance of payments. Since the discrepancies between income and expenditures and between financial assets and liabilities tend to be small (at least in annual averages), the difference in the two gross saving measures is dominated by movements in the balance of payments discrepancy. This latter discrepancy is the difference between the balance on current account and the net flows of foreign and domestic assets, which are approximately the measures of net foreign investment in the NIPA and FOF, respectively.

GROSS SAVING DISCREPANCY COMPARED TO FOREIGN SECTOR DISCREPANCY (BILLIONS OF DOLLARS)



The NIPA-FOF discrepancy in the foreign sector could be caused by an understatement of net exports, an understatement of net capital flows, or both. If the balance of payments discrepancy reflects an understatement of net exports of goods and services then, because the statistical discrepancy between gross saving and investment (NIPA) is small, this implies that NIPA estimates of saving are too low. If the cause of the balance of payments discrepancy is an understatement of capital inflows then the FOF would overstate domestic savings. Many experts feel that the likely source of the balance of payments discrepancy is in the capital accounts and as a result prefer the NIPA measure of gross saving.

III. The Composition of Personal Saving

Personal saving is only one component of overall saving. The measures of personal saving in this section are based on the FOF definitions. Thus, these measures include insurance and pension reserves as financial assets and net purchases of consumer durables (purchases less depreciation) as part of net investment.

Total personal saving as shown in the following table has increased 18.5 percent since 1980, compared with a 26 percent rise in nominal GNP. Saving has declined relative to GNP in both the NIPA and FOF accounts.

Personal Saving (\$ billions, annual average)

	<u>1965- 1969</u>	<u>1970- 1974</u>	<u>1975- 1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
Total Saving	73.4	110.3	177.3	236.1	286.7	306.9	279.8
Increase in Financial Assets	65.5	122.2	237.8	323.1	354.2	365.2	436.7
Deposits & Currency	30.2	72.3	112.9	129.4	92.1	143.5	237.8
Money Market Shares	-	.5	8.6	29.2	107.5	24.7	-44.1
Gov. Securities	9.0	7.5	28.9	39.5	58.1	59.7	73.8
Corp. Equities	-3.6	-3.7	-6.4	-	-31.7	3.5	9.9
Other Securities	5.4	7.2	9.4	-2.6	-7.3	-17.6	1.5
Insurance & Pension Reserves	19.2	30.0	61.1	89.6	101.8	120.4	142.7
Other Assets	5.4	8.4	23.4	37.9	33.6	30.9	15.0
Net Tangible Investment	49.2	71.1	109.0	88.8	112.8	69.3	101.6
Owner Occupied Homes	14.3	23.7	50.1	52.6	48.3	26.1	49.0
Consumer Durables	23.5	30.0	45.1	32.8	39.7	35.3	49.3
Non Corp. Business	11.4	17.4	13.8	3.4	24.8	7.9	3.3
Increase in Debt	41.3	82.9	169.4	175.8	180.3	127.6	258.5
Mortgages	15.8	33.2	85.1	98.3	78.8	55.8	105.6
Consumer Credit	9.0	14.8	33.9	4.9	24.1	18.3	51.3
Other	16.5	34.9	50.4	72.6	77.4	53.5	101.6

SOURCE: Federal Reserve Board

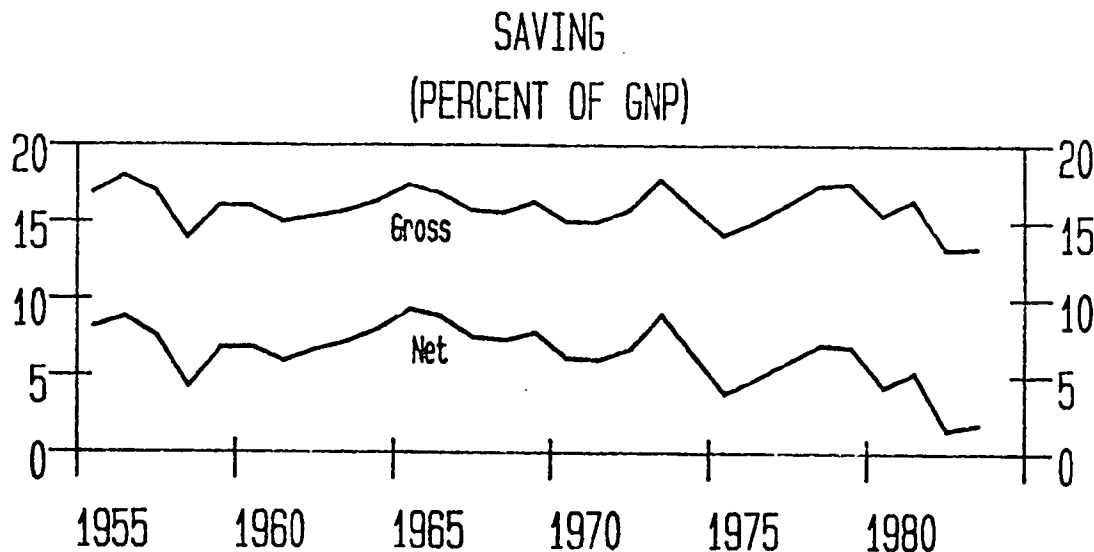
As the table also shows, increases in financial assets have risen by a third between 1980 and 1983, from \$323.1 billion to \$436.7 billion. Strong growth has occurred in deposits and currency, in part the result of new savings instruments that compete with money market funds, and in insurance and pension reserves and purchases of government securities. The rate of accumulation of other financial assets (security credit, mortgages, and other insurance reserves) slowed.

Net tangible investment was \$101.6 billion in 1983, about 14 percent more than in 1980, but still below the 1975-1979 annual average. Housing investment, though well above 1982 levels, remained low by historical standards reflecting the moderate pace of housing construction and sales. Investment by noncorporate business was small in 1983.

Increases in debt rose by 47 percent between 1980 and 1983, with 1983 showing virtually all the advance. The increase in consumer credit was large last year, particularly when compared with 1980. However, 1980 was a recession year, and a year in which the Federal Reserve restricted the use of credit.

IV. Gross and Net Saving -- An Explanation of Recent Trends

As discussed in Section I, gross saving averaged 15.9 percent of GNP between 1955 and 1983. In the past two years the ratio was only 13.2 percent. Trends in net saving (gross saving less depreciation) relative to GNP have deteriorated even more substantially. Net saving averaged 6.8 percent of GNP between 1955 and 1981, dropping to only 1.7 percent in 1982 and 1983.



Note: If net saving were measured relative to net national product (GNP less depreciation) the ratio would not decline as sharply.

Several factors account for these trends, including the 1982 recession, large Federal budget deficits, increased net foreign investment in the U.S., and larger depreciation charges because of shifts in the composition of investment to shorter-lived assets.

The 1982 Recession. Gross saving tends to decline in recessions because of the squeeze on undistributed corporate profits and because government fiscal positions tend to deteriorate. Net saving is affected even more strongly by recessions. Since depreciation is largely related to past levels of investment and the accumulated capital stock, depreciation does not decline during an economic downturn. In no year since 1955 has there been a decline in nominal dollar depreciation as measured by the NIPA. As a result, net saving falls very substantially during adverse economic conditions, as it did in 1958, 1974-75, and 1982.

Deficits. During a recession, government revenues are reduced and outlays increased by the slowdown in real economic activity. Historically, deficits were substantially reduced by the ensuing economic rebound. Current and projected deficits, however, are becoming more structural. They continue despite economic growth.

Between 1955 and 1974, Federal deficits averaged only 0.4 percent of GNP. This rose to 5.5 percent in 1983. Unless private saving rises dramatically to offset the increased budget deficit, gross saving (including government dissaving) will continue to be depressed. Moreover, since depreciation is based on existing stocks of capital, net saving could be expected to be even more severely affected than gross saving in the near term, as has been the case in recent years.

Increased Net Foreign Investment. Net foreign investment was -\$35 billion in 1983, or about 1 percent of GNP, though it rose rapidly throughout the year. This net foreign investment, a close approximation to the deficit in the international current account, is a source of funds. When net foreign investment is negative, gross private domestic investment will exceed gross saving, as shown in the following table. Depreciation, in such circumstances, will rise as a share of gross saving if nothing else changes.

Saving and Investment: 1983
(\$ billions)

Gross Saving	439.6
Gross Investment	437.4
Private Domestic	471.9
Net Foreign	-34.6
Statistical Discrepancy	-2.2

Depreciation. The NIPA measures economic depreciation by assuming straight-line depreciation schedules that remain fixed over time for each asset regardless of changes in tax law. As investment rises relative to GNP so depreciation rises. (Of course, straight-line depreciation schedules may or may not reflect true economic depreciation. Alternative depreciation schedules could yield different estimates of depreciation, though the magnitude of the differences remains unknown.) In addition, as the mix of assets changes toward shorter-lived assets, such as machinery and equipment as opposed to residential and business structures, depreciation will rise relative to the capital stock and possibly relative to GNP.

In the late 1950's, residential investment accounted for 34 percent of total fixed investment; nonresidential structures accounted for 29 percent and machinery and equipment 37 percent. During the last five years, however, the share of residential structures has been only 22 percent, nonresidential structures 23 percent, and machinery and equipment 55 percent. Since machinery and equipment have much shorter lives than structures, this shift has resulted in an increase in depreciation relative to the capital stock and relative to GNP, and in the process has widened the difference between gross and net saving.

Overall, as a result of these and perhaps other factors, gross saving has declined from 16.4 percent of GNP in the late 1950's to 13.2 percent recently; depreciation has increased from 9.2 percent to 11.5 percent and net saving has declined sharply from 7.2 percent to 1.7 percent.

The recent decline in the ratio of net saving to GNP may not have a large negative effect on capital formation. Decreases in the ratio due to the recession can be expected to be reversed by the current expansion. Also, net foreign investment is a source of funds, though with some longer-term adverse consequences. The government budget deficit, however, does pose a long-term problem for saving and capital formation.

V. Personal Net Worth and Saving

Personal net worth is total assets (financial and tangible) less financial debt. Increments to net worth arise from the flow of saving, which was discussed in detail in section III, and any revaluation (capital gains or losses whether realized or not) of the existing stock of assets and liabilities. The Federal Reserve develops annual estimates of net worth based on the FOF methodology. The following table provides estimates for 1982 and 1983.

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In 1983, personal net worth was \$11.2 trillion, an \$847 billion (or 8.2 percent) increase from 1982. This increase represented \$280 billion in saving and investment and \$567 billion in revaluations and discrepancies in the various asset and liability components.

Personal Net Worth and Saving
(\$ billions)

	<u>1982</u>	<u>1983</u>		
	<u>Net Worth</u>	<u>Saving & Investment</u>	<u>Revaluations & (Discrepancy)</u>	<u>Net Worth</u>
Financial Assets	5477.4	436.7	228.6	6142.7
Deposits & Currency	1796.3	237.8	-1.4	2032.7
Money Market Shares	206.6	-44.1	-	162.6
Government Securities	506.0	73.8	5.2	585.0
Corporate Equities	1322.3	9.9	187.3	1519.5
Other Securities	106.1	1.5	-8.8	98.8
Insurance & Pension Reserves	1179.4	142.7	46.2	1368.3
Other Assets	360.7	15.0	0.2	375.9
Tangible Assets	7251.1	101.6	333.8	7686.5
Residential Structures	2612.4	49.0	83.5	2744.9
Consumer Durables	1096.7	49.3	5.0	1151.0
Land	2541.3	-	225.6	2766.8
Other Assets	1000.7	3.3	19.8	1023.8
Financial Debt	2352.1	258.5	-4.4	2606.2
Mortgages	1572.2	105.6	58.6	1736.4
Consumer Credit	430.7	51.3	2.8	484.8
Other Debt	349.2	101.6	-65.8	385.0
Total Net Worth	10376.5	279.8	566.8	11223.1

NOTE: Discrepancies reflect discontinuities in the underlying statistical series. Personal net worth includes the net worth of households and farm and nonfarm noncorporate business.

In 1983, the major revaluations were in corporate equities and land holdings. The value of corporate equities held by persons rose by \$187 billion, up from a \$156 billion gain in 1982. The value of land holdings rose by \$226 billion in 1983. During the inflationary period 1978-1980, the increases in land values averaged about \$320 billion per year. Between 1955 and 1983, personal net worth rose by 731 percent compared with an increase in GNP of 728 percent. Data on selected sub-periods are given below.

Personal Net Worth, Saving, & Income Comparisons
(annual percent change)

	<u>1955- 1965</u>	<u>1965- 1975</u>	<u>1975- 1983</u>
Net Worth	5.7	7.2	11.4
Gross Saving*	5.9	10.6	7.9
Net Saving*	7.5	10.8	4.2
Disposable Income*	5.6	8.7	10.3
GNP*	5.6	8.4	10.0

*NIPA Definitions

VI. International Comparisons

Among selected OECD countries, the United States has had the lowest ratio of national saving to GNP, and one of the lowest ratios of household saving to disposable income. Moreover, these rankings apply even after adjustments for differing institutional arrangements and differing definitions of saving and income.

The following comparisons of United States and foreign saving rates use the System of National Accounts (SNA) which is accepted by the OECD and United Nations. There are important definitional difference between the SNA and NIPA. For personal saving, the NIPA treats estate and gift taxes as current outlays, while the SNA treats these taxes as capital outlays, financed by running down assets. Thus SNA personal saving rates will be higher than NIPA's. The SNA also treats government construction and equipment purchases (excluding military hardware) as investment, while the NIPA counts all government outlays as current consumption.

Gross Saving Rates: 1970-1980
(percent)

	<u>National</u>	<u>Personal</u>
United States (NIPA)	16.0	12.1
United States (SNA)	18.6	12.6
Canada	22.1	13.8
Japan	35.0	25.0
Australia	22.3	16.8
France	24.1	16.7
Germany	25.1	-
Italy	22.3	25.1
Sweden	21.5	8.3
United Kingdom	19.0	10.9
U.S. Rank	9/9	6/8

NOTE: National saving is calculated as a percent of gross national disposable income (gross saving plus private and government consumption). Personal saving is calculated relative to gross disposable income (gross personal saving and consumption).

Source: Blades & Sturm, "The Concept and Measurement of Savings: The United States and Other Industrialized Countries," Saving and Government Policy (Federal Reserve Bank of Boston, 1982).

Blades and Sturm adjust national and personal saving rates for institutional differences among countries and alternative definitions of income and saving.

Institutional Differences. Institutional differences that affect personal saving rates are social security pensions, public health and education expenditures, and tax structures. However, even adjusting for these institutional differences, the saving rate in the United States remains low relative to other countries.

The SNA treats social security schemes as current outlays, while treating private pensions as capital transactions. Treating all social security pension fund transactions as private funds results in shifts in saving rates depending on the relative mix of private and public pensions in each country. The results of such a calculation are shown in column 2 of the following table.

The SNA includes health and education expenditures paid for directly by persons in private consumption. Health and education services purchased indirectly from government by taxation are counted as government consumption. Shifting this spending from the government to persons, and assuming that direct taxes are reduced by an identical amount, results in the saving rates shown in column 3.

Countries rely on different mixes of taxes to finance government, either direct taxes--income and social security taxes--or indirect taxes--value added taxes, import duties and sales taxes. The level of saving is not affected by the mix of taxes in an accounting sense, but calculated saving rates are affected because disposable income is affected. Column 4 shows saving rates adjusted so that consumption taxes are replaced by direct taxes.

Personal Saving Rates: 1970-1980
(percent)

	(1) <u>Gross Saving</u>	(2) Including Saving of Social Security Funds	(3) Adjusted for Gov. Health & Education	(4) Adjusted for Expenditure Taxes
United States	12.6	13.7	11.9	13.4
Canada	13.8	15.3	-	16.0
Japan	25.0	27.6	23.7	26.3
Australia	16.8	-	15.3	18.7
France	16.7	17.6	-	20.2
Italy	25.1	24.8	23.0	28.1
Sweden	8.3	14.4	6.8	10.4
United Kingdom	10.9	11.4	9.0	12.5
U.S. Rank	6/8	6/7	4/6	6/8

National saving rates are unaffected by shifts in public pension accounting or private vs. public spending for health and education, but are affected by tax structure. The following table shows national saving rates adjusted by replacing consumption taxes with direct taxes.

National Saving Rates: 1970-1980
(percent)

	<u>Gross Saving</u>	<u>Adjusted for Expenditure Taxes</u>
United States	18.6	19.6
Canada	22.1	24.3
Japan	35.0	36.7
Australia	22.3	25.8
France	24.1	27.6
Italy	22.3	24.4
Sweden	21.5	24.3
United Kingdom	19.0	20.9
U.S. Rank	8/8	8/8

Definitional Differences: Personal saving rates are also affected by whether consumer durable purchases are treated as current outlays or capital outlays, whether private education spending is a current or a capital outlay, and whether adjustments are made for inflation gains or losses. Even adjusting for definitional differences, the saving rate in the United States remains low relative to other countries. The following table makes those adjustments.

Personal Saving Rates: 1970-1980
(percent)

	<u>Gross Saving</u>	<u>Including Consumer Durables</u>	<u>Including Private Education</u>	<u>Including Inflation Gains or Losses</u>
United States	12.6	20.7	14.4	10.7
Canada	13.8	23.8	16.3	12.0
Japan	25.0	28.2	26.2	21.1
Australia	16.8	-	17.3	-
France	16.7	23.6	17.0	13.3
Italy	25.1	28.6	25.4	-
Sweden	8.3	16.2	8.5	-
United Kingdom	10.9	17.9	12.7	4.0
U.S. Rank	6/8	5/7	6/8	4/5

National saving rates are also affected by the inclusion of consumer durables and education (private and public) in saving. The following table reflects this adjustment in a comparison of national saving rates that include R&D spending in investment rather than as a current outlay.

National Saving Rates: 1970-1980
(percent)

	<u>Gross Saving</u>	<u>Including Consumer Durables</u>	<u>Including Education</u>	<u>Including R&D Spending</u>
United States	18.6	24.3	24.7	19.5
Canada	22.1	28.4	-	22.3
Japan	35.0	37.0	39.4	36.1
Australia	22.3	-	26.2	-
France	24.1	28.9	-	24.6
Italy	22.3	25.5	26.7	22.6
Sweden	21.5	25.6	27.1	22.1
United Kingdom	19.0	23.4	24.5	19.3
U.S. Rank	8/8	6/7	5/6	6/7

VII. Saving Policy: Broad Considerations

Recent declines in gross saving are troublesome for two reasons. In the short run, changes in the propensity to consume or save can have an important impact on the pace of economic growth. A decline in personal saving stimulates the economy in much the same way as a reduction in personal taxes. Both provide for a higher level of consumption and output in the short term, for any given initial level of disposable income. Alternatively, a rising saving rate might mean less personal consumption, offsetting any fiscal stimulus from the government sector and, in the process, holding down both inflation rates and interest rates.

In the longer run, saving and investment are needed to maintain, expand, and modernize the nation's capital stock, thus adding to the productive capacity of the economy.

Concern about the growth and quality of United States productive capacity has assumed new urgency because of recent declines in saving. The central question is whether personal or total saving behavior can be altered measurably by public policy.

Until 1981, gross saving relative to GNP had been relatively stable, aside from business cycle effects, and despite rather significant changes in inflation rates, demographics, interest rates, and tax rates. Moreover, research has failed to demonstrate convincingly

that any of these factors has had an important direct effect on saving during the post-WWII period. It is difficult to argue, therefore, that incentives in the range of magnitude normally considered can be effective in changing the nation's private saving behavior. On a grander scale, however, two lines of approach merit attention.

One approach is fundamental tax reform. A consumption-based tax system, one that is being studied in a CCEA Working Group, could exempt all saving from taxation and thus dramatically increase saving incentives. Past experience, however, provides little guidance as to the magnitude of any effect. Principles underlying such a system should include the following:

- o Equal Incentives for Various Types of Saving. The Internal Revenue Code already has numerous provisions to enhance saving incentives, including deductions for retirement saving, dividend and interest exclusions, and special treatment for capital gains income. Because these provisions were enacted independently, and because not all forms of saving are given equal treatment, tax benefits accrue to individuals who merely shift assets from one form of saving to another. Tax revenues are reduced with no necessary increase in saving. Any new tax system should provide equal incentives for various types of saving.
- o Elimination of Opportunities for Arbitrage. A new tax system should treat positive saving and negative saving (borrowing) equally. Currently, taxpayers can borrow money, the interest on which is tax deductible, to invest in assets whose return is partially or fully exempt from taxation. Thus, taxpayers can save on taxes without doing any additional saving.

The second and most direct, gross saving would be increased if we reduced the Federal budget deficit. The Federal government competes directly in the market for sources of funds, and unless private sources of funds increase dramatically, which is unlikely, gross saving must fall as Federal borrowing becomes larger. This is the likely explanation for the continuing low ratio of gross saving to GNP. Reducing the deficit by reducing spending is the most direct way to increase gross saving. A second option would be to raise taxes in ways which will not affect saving.



UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for Economic Affairs
Washington, D.C. 20230

C#403

July 26, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM:

Sidney L. Jones
Sidney L. Jones
Under Secretary for Economic Affairs

SUBJECT:

Effects of Demographic Shifts on the Economy:
Immigration Issues

Much of the public discussion of changing U.S. immigration patterns has been marked by misunderstanding of the changes themselves and their effects. This paper seeks to sharpen understanding of these developments by describing trends in the main components of net immigration -- legal immigration, including refugees and asylees, emigration of former immigrants, and net illegal immigration -- and by assessing the costs and benefits of legal and illegal immigration for the nation at large. 1/

Net Immigration: Twentieth Century Trends

Legal Immigration. The level and composition of legal immigration to the United States has been determined by law since the early 1920s. In recent years, total legal immigration to the United States has ranged between 450,000 and 550,000. On average, about 120,000 of these immigrants have been refugees (mainly from Southeast Asia, but also from Eastern Europe, the Soviet Union, and Afghanistan). The rest have been newly arrived aliens admitted for permanent residence.

The flow of legal immigration was much heavier during the early part of this century. From 1905 to 1914, an average of over one million immigrants per year were admitted to the United States.

1/ The Administration has been committed to immigration reforms that would curb the entry and presence of illegal aliens in the United States since 1981. The bill passed by the Senate in 1982 and again in 1983 and the House in June 1984 would make it illegal to knowingly hire aliens illegally present in the United States and would establish a system to verify eligibility to work for all new hires. It would also legalize that portion of the illegal population which is self-supporting and has been here for a substantial period of time. The bills have not gone to conference and it is now unlikely that a final agreement can be reached during this session.

Legal immigration has amounted to roughly 15 percent of total U.S. population growth since 1980. This is a smaller share than in the 1910s when net immigration accounted for about 30 percent of total population growth, but much larger than in the 1930s and early 1940s when the share was about two percent. (By the 1950s, the share had increased to eight percent; by the 1960s, to 10 percent; and by the 1970s, to 14 percent.)

The sources of legal immigration have also changed. Approximately one-third of legal immigration now comes from Asia, compared with only six percent thirty years ago. Since the 1950s, the Latin American share of legal immigration has grown from 25 percent to 40 percent, and the Canadian and European share has fallen to one-fifth from more than two-thirds.

In addition, the 1980 census indicates that for the first time since the high immigration years of the 1900s and 1910s, the share of total U.S. population which is foreign-born has increased (to 6.2 percent from 4.6 percent in 1970). In absolute terms, this segment of the population (14 million in 1980) was only a few hundred thousand short of the all-time high.

Emigration of Former Immigrants. Emigration has proven hard to measure. However, available data indicate that roughly 30 percent of legal immigrants (more than 100,000 per year in recent years) eventually emigrate. This relationship appears to have persisted throughout the present century. The reasons for it are not well known, though presumably they include lack of employment, poor cultural adaptation, and retirement.

Net Illegal Immigration. Estimates of the size of the illegal alien population vary within the range of 2 million to 12 million (or even more) and lack empirical support. However, recent research at the Census Bureau and elsewhere suggests some overall limits on the size of this population in 1980.

Based on comparisons of aggregate 1980 census data with figures on legal aliens derived from Immigration and Naturalization Service (INS) data, Bureau researchers estimated that about two million illegal aliens were counted in the census. (Of these, slightly over half were born in Mexico). In all probability, this is an undercount. Estimates of illegal immigration are largely guesswork because data are lacking. By all estimates, however, the number of illegal aliens in the United States in 1980 was significant, and in view of economic and other difficulties in Mexico and Central America, this number may have grown at an increasing rate since 1980.

Although the precise number of illegal aliens in this country in 1980 is unknown, the census research suggests that as a group they are young--seven out of eight are under age 40 and about one in five is less than 15. About 60 percent of the adults are male; roughly 25 percent of the total were in the United States before 1970; and about two-thirds are Hispanic. Illegal aliens appear to come from the world over, but Mexico stands out as by far the largest source, with the rest of the Caribbean basin also providing substantial numbers.

Future Immigration. Future levels of legal immigration are subject to legislative and executive control and can be adjusted to match policy goals. Large backlogs of applications for admission as permanent resident aliens exist in many sending countries (e.g. Mexico, 313,496; Philippines, 308,261). Moreover, as more aliens are admitted for permanent residence, the pool of persons eligible for admission under family reunification criteria becomes larger.

In addition, the forces that drive illegal immigration -- excess population and poverty in the less developed countries -- are unlikely to abate in the near term. Indeed, they may increase. The Census Bureau's population projections for Mexico illustrate the pressures. Over the next 20 years, the Mexican labor force will double with the addition of 20 million workers who are already born. Unless the Mexican economy is much more successful in creating jobs than it has been, the incentive to cross the U.S. border will increase. Similar projections characterize the rest of the Caribbean basin. Thus, if U.S. policy is to control immigration during the next decade, we will probably have to devote increasing resources to enforcement.

Social and Economic Effects of Recent Immigration Patterns

Much of the discussion of the effects of higher levels of immigration on the United States has focused on presumed negative impacts -- e.g., the added public burden of supporting the increased population, and the displacement of native-born workers. However, the available evidence raises questions about these presumptions.

Immigration contributes to higher U.S. population growth directly and indirectly because new arrivals tend to be concentrated in the child-bearing ages and to have high fertility rates. This higher population growth may carry with it certain costs, but it also promises important benefits.

Fueled by the postwar "baby boom," the U.S. working age population expanded at an annual rate of two percent during the

1970s. Recently, however, as the "baby bust" cohorts of the 1960s began to reach working age, this growth dropped to about one percent per year. Some analysts believe that this could hamper future economic expansion. Also, since the number of persons of retirement age will continue rising through the early decades of the next century, this slower labor force growth could impose a growing financial strain on the social security system. Immigration can help to offset both the long-term constraint on the labor pool and potential pressures on the social security system.

In addition, because most immigrants are adults, the United States gains human capital in the form of labor and education. On average, legal immigrants have about as much education as native-born Americans (illegal immigrants have less). Legal immigrants also tend to be self-reliant and innovative (they must be to face the challenge of a new culture), and once in the United States, they become consumers, entrepreneurs, and taxpayers.

On the negative side, generally low-skilled illegal immigrants may need more social support than other U.S. residents as they age. The demand for their unskilled labor may fall over time, and their schooling and language limitations may leave them ill-suited for retraining. They may also have greater medical problems in later years than the average American, due to the dietary and health habits of their early years.

Some observers argue that immigrants displace American workers from their jobs and that illegal immigrants in particular are willing to accept low pay and poor working conditions, thus driving down wage rates for themselves and domestic workers. The evidence is mixed. In some industries, where immigrants (especially illegals) are concentrated, some displacement may occur. Some immigrants, particularly illegals, accept relatively undesirable, low-paying jobs which most Americans shun (though studies by INS suggest that illegal immigrants' wages are not as low as is commonly thought). Overall, low-paying and undesirable jobs are held predominantly by domestic workers, except in locales with concentrations of foreign-born workers.

Often overlooked in the argument about job displacement is the job creation that results from spending by immigrant consumers and from small businesses started by immigrants. By increasing the size of the labor force, immigrants enhance the economy's growth potential. Also, to the extent that lower labor costs result in lower priced goods and services, all consumers benefit.

Though immigration is a national issue, many of its effects are concentrated at the local level, particularly in California, Texas, Florida, and the cities of the northeast. Despite evidence that legal and illegal immigrants do not abuse welfare and government services, in areas where population growth has increased local governments must supply more police and fire protection, more sanitation service, more health service, and more classrooms and teachers. In addition, some immigrants may have special needs. This is particularly true of refugees who may have no familial support network, somewhat lower skills than other immigrants, and who typically have lost their possessions in their flight from oppression.

Illegal immigration also poses a social integration problem. Because of their continuous fear of deportation, illegals are reluctant to participate fully in American society. There is evidence, for example, that illegals are often victims of fraud and crime, but that their fear of contact with governmental agencies leads them to suffer silently without going to police or other enforcement authorities.

Finally, any reckoning of the total cost of immigration to American society must also include the costs of enforcement. Control of immigration, particularly illegal immigration, can be expensive in terms of financial and social costs.